

Liquor Control Board
**Wine and Beer
Three-Tier System Review
Task Force**

June 15, 2006 - Meeting #3



Welcome!



- **Introductions**

Agenda



	Topic	Purpose	Time	Outcome	Lead by
1.	Welcome / Introductions / Agenda / Previous meeting minutes	Information	10 minutes (10:00-10:10)	Information	Nate Ford (Task Force Chair)
2.	<i>Summary:</i> previous meeting decisions	Review	10 minutes (10:10-10:20)	Information	Sterling Associates
3.	<i>Presentations:</i> primary issues from stakeholders not represented on the Task Force	Information	40 minutes (10:20-11:00)	Information	WPEA; Independent Distributors; Independent Grocers; Sports/Entertainment;
5.	<i>Review and discuss:</i> results of change survey	Information	60 minutes (11:00-12:00)	Inform vote on change candidates	Sterling Associates
6.	<i>Prioritization:</i> of survey items	Decision	15 minutes (12:00-12:15)	Decision on priorities for further research	Sterling Associates/ Task Force Members
	Lunch		12:15 – 12:45		
4.	<i>Presentation:</i> overview of relevant federal regulations	Information	30 minutes (12:45-1:15)	Information	Bernie Kipp – Alcohol and Tobacco Tax and Trade Bureau
7.	<i>Discuss:</i> results of prioritization and potential alternatives	Information exchange	75 minutes (1:15-2:45)	Guidance on research and potential alternatives	Sterling Associates
8.	<i>Wrap up-adjourn</i>		15 minutes (2:45 – 3:00)		Sterling Associates

Previous Meeting



- **Charter adopted**
- **Three recommended policy goals adopted**
 1. *Prevent the misuse of alcohol.*
 - *“Misuse of alcohol” includes underage sales/drinking, driving while under the influence, serving to inebriated consumers, public inebriation, sales outside of the regulated system, or any other use that could promote public harm or create safety or nuisance issues.*
 - *In an attempt to prevent misuse, the state should not affect responsible moderate consumption.*
 - *“Responsible moderate consumption” is the public sale/consumption of alcohol by legal adults, without misuse.*
 2. *Promote the efficient collection of taxes.*
 3. *Promote the public interest in fostering the orderly and responsible distribution of malt beverages and wine towards effective control of consumption.*
 - *The LCB’s working interpretation of this goal is: the avoidance of pressure on any one industry (producers, distributors, or retailers) from another that would cause collusion or result in unfair advantages or disadvantages that may result in over-consumption or increased access by minors.*
- **Agreed to complete potential change surveys in preparation for prioritization process at June 15 meeting**

Since May 18 meeting

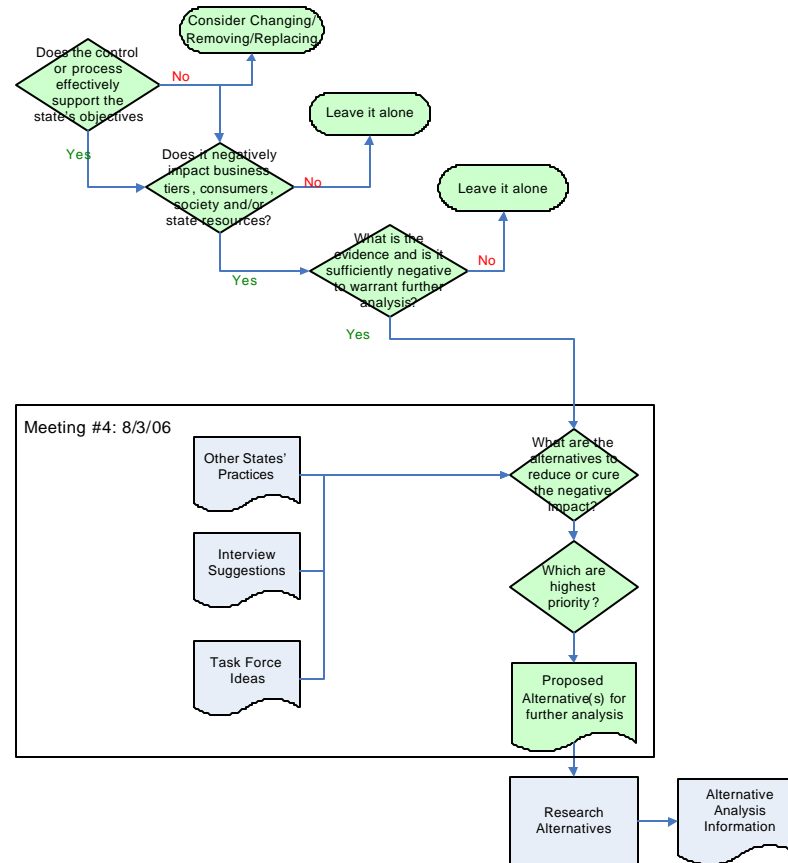


- **Potential change item surveys completed (received from 15 Task Force members)**
- **Survey results consolidated and distributed to members for review**
- **Five sets of other stakeholder comments received and forwarded**
(see handout. Note: one item was distributed at the previous meeting)
 - Contract Liquor Store: Would like modifications to the current restrictions on where contract store owners can purchase their wine, and increase in allowed markup.
 - Internet Wine Retailer: Would like internet sale issues addressed. Would like to be able to work with different wine shops to bundle wines from different wineries into one package (as can be done in California).
 - Small Winery Owner: Concerned about the state's involvement in regulating wine sales, and about the process being designed to favor the status quo.
 - University of Miami School of Law Professor: Submitted at the request of WBWWA, elaborates on two points the author feels has not been adequately addressed by the materials provided to the Task Force members to date. Concludes that Washington laws are sound and should not be tampered with lightly.
 - Professor of Economics, Washington State University: At request of WBWWA reviewed materials generated to date by Task Force. Believes the net effects of the three-tier system and other beer and wine regulations are somewhat higher prices, much more controlled access, and more effective tax collection. Elimination of restraints that "level the playing field" can be expected to result in fundamental changes in the marketing structure.

Objective of Today's Meeting



- **Prioritize potential change issues to focus research and alternative analyses**

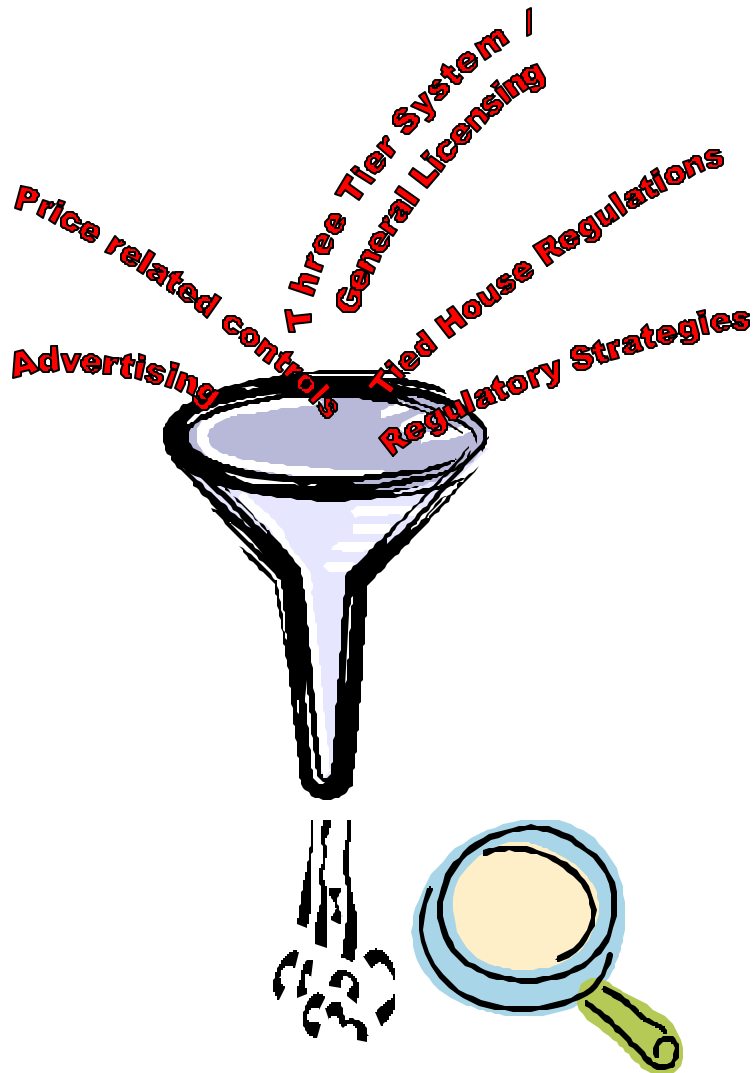


Stakeholder Presentations



- The LCB identified participants for the Task Force to comply with the legislation and to encourage as much diversity as possible while keeping the size manageable to accomplish the large volume of work required.
- The Task Force process includes opportunities to attend meetings and submit comments throughout, and information is posted to the LCB website regularly.
- Several stakeholder groups who do not feel they are adequately represented on the Task Force will have the opportunity today to present their specific issues for consideration by the Task Force.
 - Washington Public Employees Association
 - Independent distributors
 - Independent grocers
 - Sports and Entertainment facility operators

Survey Results



- The survey is intended to be a way to gather input on Task Force members' priority issues and to identify which items to move forward for further discussion - it is not a decision on the change itself.
- The survey results are intended to stimulate discussion and are informational only. The task force will prioritize these items during the lunch period.

Survey Results



- **26 items were included in the survey, covering a variety of topics related to the three-tier system including:**
 - Advertising
 - Anti-Competition Regulations
 - Tied-House
 - Price Controls
 - Three-Tier System / General Licensing
- **One item (Impacts of Provisions in 2SSB 6823) was not included in the prioritization process because the legislature directed the Task Force to consider the impacts of this statutory change.**

Survey Results



4b	Price posting and hold	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	LOW	
6d	Lack of enforcement resources	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	MED	MED	MED	MED	LOW
6f	Lack of impact measures	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	MED	MED	MED	LOW	LOW
3a	Money's Worth Provisions	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	MED	MED	MED	LOW	
4d	Quantity discounts prohibited	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	MED	MED	MED		
4c	Mandatory minimum 10% price mark-up	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	MED	MED	LOW	LOW	
5a	Mandatory use of distributors	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	MED	LOW	LOW	LOW	
4a	Uniform pricing	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	MED				
3b	Prohibition of Ownership interest between producers and retailers	HIGH	HIGH	HIGH	HIGH	HIGH	MED	LOW	LOW			
2	Anticompetition Regulations	HIGH	HIGH	HIGH	HIGH	HIGH	LOW	LOW	LOW			
6c	Priority of enforcement resources	HIGH	HIGH	HIGH	HIGH	MED	MED	MED	MED	ED/LOW	LOW	
6a	Criteria for consideration in developing regulations	HIGH	HIGH	HIGH	HIGH	MED	MED	MED	LOW	LOW	LOW	LOW
5d	Prohibition on retail-to-retail distribution	HIGH	HIGH	HIGH	HIGH	MED	LOW	LOW	LOW			
7b	LCB in competition with other retailers by selling beer and wine	HIGH	HIGH	HIGH	HIGH	MED	MED	MED	LOW			
7a	Rules for LCB retailing	HIGH	HIGH	HIGH	MED	MED	MED	MED	MED	MED	LOW	
5f	Prohibition on central warehousing	HIGH	HIGH	MED	MED	MED	MED	MED	MED	LOW	LOW	
6g	General regulation complexity, language, and relevancy	HIGH	HIGH	MED	MED	MED	MED	MED	LOW	LOW	LOW	
5e	Prohibition on sampling in grocery stores/at on-premise licensees	HIGH	HIGH	MED	MED	MED	MED					
5g	Restrictions on product placement in grocery stores	HIGH	HIGH	MED	MED	LOW	LOW					
5c	Foreign import distribution regulations	HIGH	HIGH	MED	LOW							
6e	Abundance of paperwork	HIGH	MED	MED	MED	MED	MED	LOW	LOW	LOW		
4e	Delivered pricing from distributors to retailers	HIGH	MED	MED	MED	MED	LOW	LOW				
1	Advertising Regulations	HIGH	MED	MED	MED	MED	LOW					
4f	COD requirements for retailers	HIGH	MED	MED	LOW	LOW						
3c	Return on damaged goods	MED	MED	MED	LOW	LOW	LOW					

All issues included in the survey were identified as a priority issue at some level.

All topics but one (return of damaged goods) were identified by at least one task force member as a high priority to consider for change.

Survey Results



Price Posting (and hold) was identified by the greatest number of Task Force members (nine) as a high priority to consider for change

Top 10 issues identified in the survey as a high priority by Task Force members:

4b	Price posting and hold	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	LOW	
6d	Lack of enforcement resources	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	MED	MED	MED	MED	LOW
6f	Lack of impact measures	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	MED	MED	MED	LOW	LOW
3a	Money's Worth Provisions	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	MED	MED	MED	LOW	
4d	Quantity discounts prohibited	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	MED	MED	MED		
4c	Mandatory minimum 10% price mark-up	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	MED	MED	LOW	LOW	
5a	Mandatory use of distributors	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	MED	LOW	LOW	LOW	
4a	Uniform pricing	HIGH	HIGH	HIGH	HIGH	HIGH	HIGH	MED				
3b	Prohibition of Ownership interest between producers and retailers	HIGH	HIGH	HIGH	HIGH	HIGH	MED	LOW	LOW			
2	Anticompetition Regulations	HIGH	HIGH	HIGH	HIGH	HIGH	LOW	LOW	LOW			

Voting Instructions



- Use your dots to identify for your high, medium and low priority potential change items (1 dot per item – you don't have to use them all)

Lunch



Federal Regulations



- In addition to state statutes and rules, there are federal regulations related to wine and beer sales, distribution and tied-house prohibitions that apply to interstate activities.
- Bernie Kipp is the District Director of Investigations for the Northwest region of the Alcohol and Tobacco Tax and Trade Bureau (*see handout*)

Results of Voting



- **Priority indicated used to “rank” the list of *potential* change candidates.**
 - Something lower on the list does not necessarily mean it will not be addressed. The list will help us focus attention where the Task Force is most interested in affecting potential change. The list will not be static, but may change as the discussions continue and decisions are made.
- **The next step will be discussion of possible alternatives and presentation of available research to the current statute/rule/practice/circumstance.**
 - It is possible that as the Task Force moves forward with its consideration of issues and change alternatives are identified, the group may decide one or more items should be removed as candidates for change.

Results



- (TBD)

Wrap-up



- **What we accomplished today**
- **Next meeting's purpose and "homework" assignments**
 - Date/Time: Thursday August 3, 10a – 3p. LCB Headquarters (room to be determined).
 - Purpose: to begin discussing change alternatives and present research conducted to date.
 - Homework:
 - Review information you receive, including summary of today's meeting and next meeting materials.
 - Send general questions or comments to Sterling Associates by Friday 7/28 if it needs to be included for 8/3 meeting. (Public too.)
- **Questions?**

Adjourn



- Thank you!
- See you August 3...



Appendix - Info



- **Written comments from stakeholders and/or Task Force meeting audience are welcome (contact information must be included) and can be submitted via:**
 - LCB web site: WWW.LIQ.WA.GOV (link to Task Force)
 - Email to Sterling Associates (please address to both)
 - Jill Satran – jills@sterling-llp.com
 - Kim Rau – kimr@sterling-llp.com
- **Written comments received by Fridays before a Task Force meeting will be included in a consolidated document to the Task Force members. Written comments will be summarized and presented at each Task Force meeting. (They will not necessarily be individually addressed via email or by the Task Force.)**
 - Written comments submitted to the Task Force will be also be available for public viewing on the LCB's web site.



Alcohol and Tobacco Tax and Trade Bureau

Bernard J. Kipp

District Director of Investigations – Northwest

Federal Alcohol Administration Act (1935)

- Gave Federal Gov. power to regulate :
- Who can produce or introduce alcohol into commerce
- How it must be packaged/labeled
- How it can be marketed/sold
- (Last 2 must have element of interstate commerce)

Business Practice Regulations

LAW- Federal Alcohol Administration Act
(Unfair Competition and Unlawful Practices
proscribed by law)

Regulations (Amended in 1995)

Tied House – 27 CFR Part 6

Exclusive Outlet – 27 CFR Part 8

Commercial Bribery – 27 CFR Part 10

Consignment Sales – 27 CFR Part 11

Elements required for a “federal case”

Requirement or Inducement

or

Offer of Consignment or other than
bonafide sale

Exclusion

Interstate or foreign commerce

Similar state law for malt beverages

TERMS

- **Industry Member** Producer of distilled spirits, wine, malt beverages, Importer, or Wholesaler
- **Trade Buyer** Wholesaler or Retailer of distilled spirits, wine, or malt beverages

Changes to Parts 6,8,10, and 11 of regulations

- “Exclusion” defined by regulations
- Practices which result in Exclusion defined in Part 8
- Practices which put retailer’s independence at risk defined in Part 6
- Practices which put Trade Buyer’s independence at risk defined in part 10

Changes Continued

- Criteria for determining retailer independence defined for Parts 6 & 8
- Criteria for determining trade buyer independence defined for Part 10
- Other than bonafide sale defined in Part 11
- Federal Tied House exceptions liberalized in Part 6

EXCLUSION

Tied House and Exclusive Outlet

- Exclusion in General. (a) Exclusion in whole or in part occurs:
- (1) When a practice by Industry Member places a retailer's independence at risk by means of a TIE or LINK between the Industry Member and the Retailer
- AND
- Such practice results in the retailer purchasing less than it would have of a competitor's product

Criteria for determining Retailer Independence

- Practice restricts free economic choice of retailer to decide quantity & products to purchase
- Ind. Member obligates retailer to participate in promotion to obtain product
- Retailer has continuing obligation to purchase/promote Ind mem product

Criteria for determining Retailer Independence

- Retailer has commitment not to terminate purchases of Ind member's products
- Practice involves the industry member in day to day operations of retailer (Control retailers decision on purchases, pricing, & display)
- Practice is discriminatory – Not offered to all retailers in local market on same terms without business reasons justification

Exclusive Outlet

- **Application** Industry members and Retailers not wholly owned by the Industry Member
- **Jurisdictional:** Require a retailer to purchase through:
 - Coercion
 - Agreements or Contracts beyond a single sales transaction
 - Third Party Arrangements

Exclusive Outlet

- Exclusion - Practice places a retailer's independence at risk by means of a TIE or LINK between the Ind Mem & Retailer
- AND
- Practice results in the retailer purchasing less than it would have of a competitor's product

Exclusive Outlet

- Practices which result in exclusion
- Purchases by retailer due to threat of physical or economic harm by selling Ind Member
- Contracts requiring retailer to purchase alcohol beverages from certain Ind Mem & restrict retailer from purchasing products from another Ind Mem.

Commercial Bribery

- **Application** Industry members and Employees, Officers & representatives of Trade Buyers
- **Jurisdictional:** To induce a Trade Buyer to purchase by:
- Offering or giving a bonus, premium, compensation or thing of value to any officer, employee or representative of Trade Buyer

Commercial Bribery

- Exclusion Practice places a retailer's independence at risk by means of a TIE or LINK between Ind Mem & Trade Buyer

AND

- Practice results in the retailer purchasing less than it would have of a competitor's product

Commercial Bribery

- Practices which put Trade Buyer's independence at risk:
- Industry Member payments of money to the employee(s) of a trade buyer without the knowledge of consent of the trade buyer-employer in return for the employee agreeing to order alcoholic beverages from the industry member

Consignment Sales

- **Application** Transactions between Industry members and any Trade Buyer
- **Jurisdictional:** To sell, offer or contract to sell to any trade buyer or for such buyer to purchase, offer or contract to purchase
- On consignment
- Conditional sale or sale with privilege of return
- Reacquisition
- Other than bonafide sales (Includes slotting fee payments to retailers)

Consignment Sales

- Reasons not constituting return for ordinary and usual commercial reasons:
- Overstocked or slow moving products
- Seasonal Products

Consignment Sales

- Reasons constituting return for ordinary and usual commercial reasons
- Defective Product
- Error in delivery
- Product unlawful to sell
- Termination of retail business or wholesale franchise
- Change in product
- Discontinued Product
- Seasonal Dealer

Tied House

- **Application** Industry members and Retailers not wholly owned by the Industry Member
- **Jurisdictional:** Induce a retailer to purchase by:
 - Holding interest in retail license
 - Acquiring interest in retailer's business property
 - Providing things of value (subject to exceptions)
 - Paying/crediting retailer for advertising service
 - Guaranteeing a loan of retailer
 - Excessive extension of credit
 - Quota Sales & Tie In Sales

Tied House

- **Exclusion** Practice places a retailer's independence at risk by means of a TIE or LINK between Ind Mem & Retailer
- AND
- Practice results in the retailer purchasing less than it would have of a competitor's product

Tied House

- Practices which put retailers independence at risk:
- Industry Member resetting other Industry Member's stock at a retailer's premises
- Industry Member purchasing/renting display, shelf, or warehouse space from retailer
- Ownership by Ind Mem of less than 100% in retailer. Used to influence purchases of retailer
- Ind Mem. requiring retailer to purchase one alcoholic product to purchase another at the same time

Exceptions

- Practices that are exceptions to section 105 (b) (3) of the FAA Act
- (Things of Value)

Exceptions

Product Displays

POS advertising & consumer specialties

Temporary Retailers

Equipment & Supplies

Samples

Newspaper Cuts

Combination Packing

Educational Seminars

Exceptions

Consumer Tastings at Retailer

Consumer Promotions

Advertising Service

Stocking Rotation & Pricing

Participation in Retailer Association Activities

Merchandise

Outside Signs

Recordkeeping Requirements

- Industry members must keep and maintain records on premises for certain items
- Product Displays
- Equipment and Supplies
- Samples
- Coupons
- Participation in Retailers Assoc. activities
- Merchandise

Recordkeeping Requirements

- Required records for certain items furnished to retailers must be kept on premises and include:
 - Name & Address of retailer
 - Date furnished
 - Item furnished
 - Industry member's cost of item
 - Charges to retailer (if any)

LCB Three-Tier Task Force –
Written Comments Received Between May 12 to June 12, 2006

The following written comments* were submitted to the Task Force between May 12 and June 12, 2006.

1. **Jeff Smiley, WA Small Brewer:** Concerned about possible removal of self-distribution. Insulted that Task Force material seems to single out the manufacturing tier as being responsible for the harmful effects of alcohol that occurs in the industry. (Note: Mr. Smiley's comments were distributed at the last meeting, but they came in too late to be included in that meeting's summary of written comments.)
2. **Theresa Hancock, Contract Store Owner:** Currently can only purchase wine afrom the LCB distribution center. Would like to be able to sell wine purchased from other distributors, and would like the possibility of a greater markup than the 6.45% commission currently allowed.
3. **Judith Colby, USAWines.com, Internet Wine Retailer:** Would like internet sale issues addressed. Currently can only connect consumer to specific winery for sales. Would like to be able to work with different wine shops to bundle wines from different wineries into one package (as can be done in California).
4. **Mike Wade, Fielding Hills Winery, Small Winery Owner:** Other than issues of temperance and underage drinking, there is no reason for the state to be involved in regulating wine sales. With the exceptions noted, wine sales should not be controlled any more than other products, including tax collection. There are special interests vested in the current system and it appears the process is being scripted to favor a result of the status quo .
5. **Stephen Diamond, University of Miami School of Law Professor:** At request of WBWWA reviewed materials generated to date by Task Force. Materials do not elaborate on two points. 1) Significance of stable and orderly market, and 2) need for enforcement mechanisms that are practical and fiscally realistic. Related to #1 - current WA laws result in a more stable market. Related to #2 - regulation cannot be limited to policing the behavior of consumers and retailers directly, but must be comprehensive. Washington laws are sound and should not be tampered with lightly.
6. **Ken Casavant, Professor of Economics, Washington State University:** At request of WBWWA reviewed materials generated to date by Task Force. Believes the net effects of the three-tier system and other beer and wine regulations are somewhat higher prices, much more controlled access, and more effective tax collection. Elimination of restraints that "level the playing field" can be expected to result in fundamental changes in the marketing structure. The Task Force's role is make recommendations as to the appropriate balance between social costs and private efficiencies.

* *These comments were forwarded to Task Force members previously, via email.*

LCB Three-Tier Task Force –
Written Comments Received Between May 12 to June 12, 2006

Jill - what is the process by which I can ensure that the Task Force sees this kind of feedback from small brewers?

George Hancock
President
Washington Brewers Guild

From: JeffSmiley99@hotmail.com [mailto:jeffsmiley99@hotmail.com]
Sent: Wed 5/17/2006 1:17 PM
To: waguild_associates@yahoogroups.com; George Hancock
Subject: Re: [waguild_associates] FW: 3-Tier Task Force Website

This is some serious stuff. I see more pushing towards removing self-distribution. Here's an interesting passage:

Page 16 of the presentation:

"Core Assumption: manufacturer's profit motive to sell as much as it can of it's products should be mitigated because of the harmful effects of alcohol consumption; the manufacturer must be separated from the consumer"

How ridiculous is that? You mean the distributor isn't going to sell as much beer as they can to make a profit? Everyone in the chain wants to sell as much as they can. To single out the manufacturer is outright insulting. It makes it sound like the manufacturer is responsible for the harmful effects of alcohol that occurs in the industry.

George, you mentioned at the WBG meeting that you could forward feedback to the task force. Could you forward this feedback for me?

Jeff

LCB Three-Tier Task Force –
Written Comments Received Between May 12 to June 12, 2006

From: Theresa Hancock [mailto:tlcgolf@televar.com]
Sent: Friday, May 26, 2006 9:22 AM
To: Frederick, Sherry C
Subject: Comment for Three-Tier Task Force

Task Force Members,

My name is Theresa Hancock, and I am a contract liquor store manager in Washington State. There are 150+ contract liquor stores in Washington State. We are independent retailers that contract with Washington State to sell the liquor, wine and beer. I serve on the Contract Manager Advisory Committee that meets quarterly with the LCB. I also serve as the contact point between the LCB and the contract stores in regards to the CMAC group. I also served on Governor Locke's retail sales task force.

As a group we would be interested in being able to sell wine and beer other than those that we can get through the LCB. We currently are able to get a beer/wine license but LCB rule prohibits us from selling other wines that could be purchased from other distributors, but we are allowed to purchase beer from other distributors. If we were able to purchase wine we could offer a better selection to our customers. Also, our mark up on the wine from the distributor could potentially be greater than the 6.45% commission that we receive on LCB wine.

We would also like for you to keep our portion of the Three-Tier system in mind as you go through your deliberations. We do not have a lobbyist, union representation or a representative on the task force, so we do not want to be forgotten. Many of these items you are looking at will directly affect us. We do have investments in our businesses and are an important part of the retail piece.

If you would like any more information or would like to have a dialogue with the contract stores, we would be happy to give you any input needed.

One other point that I learned from the previous task force in regards to the three-tier system was that the current system does provide for a broader selection of spirits and prevents large wholesalers from gobbling up shelf space and forcing out the smaller wholesalers.

Best Regards,

Theresa Hancock
Contract Liquor Store Manager
tlcgolf@televar.com

day phone: 509-837-5445
evening phone: 509-837-8550
mobile: 509-830-2152

LCB Three-Tier Task Force –
Written Comments Received Between May 12 to June 12, 2006

From: judith@usawines.com [mailto:judith@usawines.com]
Sent: Friday, May 26, 2006 3:13 PM
To: Frederick, Sherry C
Subject: Comment for Three-Tier Task Force

As you consider the direction for new laws regarding wineries and wine shops in WA, I would appreciate your task force giving some thought to Internet sales of wine. We have been in business at www.USAWines.com for ten years now, and have felt hamstrung by WA liquor laws. The purpose of USAwines.com is two-fold: 1) to promote winery tourism, and 2) to sell wines. WA has some excellent wines and great winery tourism, and it seems a shame to have to ignore representing wineries in our home state.

When we moved from CA to WA in 1998, we asked WA Liquor Control what license we might need. We were told they had no idea how to handle Internet sales, so just go ahead as we were. Then in 2004 they contacted us and, following their advice, we secured Agent's Licenses for each of the WA wineries where we show wines for sale.

The way our shopping cart system currently works is that when someone orders wine, the order is forwarded to a winery for fulfillment. The sale is between the winery and the consumer, with the winery charging the credit card and shipping the product to states where legal. We would like to be able to work with retail wine shops in WA, as we do in CA, so as to bundle wines from different wineries into one package. However, current WA law requires that we either represent wineries or wine shops. We don't have a problem with that restriction, but if we choose to work with a wine shop, it is my understanding that would create a myriad of other complications.

If you would like some "e-tailer" representation on your Task Force, I would be happy to become involved in your discussions. Please feel free to call me with any further questions or suggestions.

USAWines.com

800-625-2610

Judith Colby
PO Box 712
LaConner, WA 98257
360-466-5094 ofc
360-391-3042 cel

LCB Three-Tier Task Force –
Written Comments Received Between May 12 to June 12, 2006

From: mike at Columbia Fruit Packers [mailto:mikew@columbiafruit.com]
Sent: Wednesday, May 31, 2006 4:24 PM
To: Frederick, Sherry C
Cc: Parlette, Sen. Linda Evans; 'George Valison'; John Morgan
Subject: Comment for Three-Tier Task Force

May 31, 2006

Dear WSLCB,

I understand scf@liq.wa.gov is the email address to submit comments regarding the 3 tier review.

I would like to submit the following to the task force for their consideration:

My wife and I own a very small winery in East Wenatchee. More of a glorified hobby than anything else, but we work very hard (with the help of family and friends) to produce world class red wines. My day job is helping operate Columbia Fruit Packers, a family owned apple and cherry growing and packing business. We produce 1.5 million boxes of apples and 750,000 boxes of cherries.

Other than the issues of temperance and underage drinking, I can see no reason for the state to be involved in regulating wine sales. I am very much aware of the massive bureaucratic system currently in place and can see no relationship to temperance or underage drinking. Why should selling a case of wine be any different than selling a case of apples? Really, why? How does price posting have anything to do with protecting the public interest (temperance and underage drinking)?

Taxes: Tax collection is an important issue for any government entity required to collect taxes, but how or why is tax collection from the wine trade any different than many other businesses?

I would strongly encourage you to reach out to the wine trade and ask for input. Create a survey form and collect information from all the stakeholders.

Please also recognize there are some very obvious "special interests" very vested in the current system. You must have the courage to openly and honestly acknowledge this reality and deal with it straight on. My review of the work done so far is troubling. It appears the process is being scripted to favor a result in the status quo. Please do not go this route.

In closing I would strongly encourage you to constantly ask yourselves how or why is this situation any different than the majority of unregulated business entities/activities in Washington State?

The magnitude of your work is huge. Please take the time to do this right.

LCB Three-Tier Task Force –
Written Comments Received Between May 12 to June 12, 2006

(Wade, page 2)

If I can be of any further help in this process please let me know.

Thank you for your time.

Sincerely,

Mike Wade
Fielding Hills Winery
East Wenatchee, WA
509-884-2221

Cc: Linda Evans Parlette
Cary Condotta
Columbia Cascade Winery Association members

LCB Three-Tier Task Force –
Written Comments Received Between May 12 to June 12, 2006

Stephen M. Diamond
1140 Asturia Avenue
Coral Gables, Florida 33134

June 5, 2006

Mr. Nate Ford, Chair
LCB Three-Tier Review Task Force

Dear Mr. Ford,

I am a professor of law at the University of Miami School of Law and have taught courses in U.S. alcoholic beverage law for ten years. In addition to my law degree, I have a Ph.D. in History. I spoke to Washington's first three-tier review task force a number of years ago.

At the request of the Washington Beer and Wine Wholesalers Association, I have reviewed the materials and comments generated to date by the Task Force. I am concerned that they do not sufficiently set forth and elaborate two important points. One is the significance of a stable and orderly market for the distribution and sale of alcoholic beverages. The other is the need for enforcement mechanisms that are practical and fiscally realistic. Accordingly, I am writing to give the Task Force some additional perspective on these points.

Washington's laws have the effect of creating a more stable market for the distribution and sale of alcoholic beverages. This was explicitly recognized by all of the expert economists who testified in the recent Costco litigation, the experts for Costco as well as those for the State and WBWWA. In this context "stable" means that sellers cannot react as quickly to ephemeral market changes, such as unanticipated promotional activities of competitors, as they could in the absence of the regulatory restraints. Prices are less volatile than would otherwise be the case. Decreased volatility is beneficial to the State for at least two reasons. The more volatile prices are, the more opportunities there are for sellers to promote the sale and consumption of beer and wine. The more volatile prices are, the easier it is for market participants to engage in discriminatory pricing practices and the harder it is for the State to detect those pricing practices.

This stability is not an accident, but was intended by the legislature that first enacted Washington's regulatory system governing the distribution and sale of beer and wine. Their aim following repeal of Prohibition was to permit only that degree of autonomy by private parties operating in the market that was conducive to and did not frustrate the state's regulatory goals of control and tax collection. Private profit seeking was to be permitted, but constrained. There was to be moderation in selling as well as in consumption. A structure was sought to make selling transparent and accountable and also to create incentives, as well as controls, that would encourage participants to work within the regulations and to help in their enforcement.

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Retailers were to be regulated in ways to reduce pressures on, and opportunities for, buyers to over-consume. Suppliers and wholesalers were to be regulated in ways to reduce pressures on, and opportunities for, retailers to oversell. In the language of the time, the "natural demand" for beer and wine was to be satisfied (because if it were not, illicit distribution and sale would be encouraged), but a stimulated demand was not to be permitted. This can still be seen in the attitudes of suppliers, particularly the large national brewers, who still routinely explain that their advertising programs are intended to steal business from their competitors, but not to attract new drinkers.

Sellers were to be encouraged to take a long-term view, aiming at steady moderate returns, rather than attempting to "get rich quick" by pushing against the regulatory boundaries. The Rockefeller Report of 1933 also encouraged stability in law-making. Its authors, Fosdick and Scott, advised against faddish and rapid regulatory changes which would only encourage short-term, get-rich-quick responses.

This kind of stable environment provides many regulatory benefits. Stability facilitates moderation in selling, and thus in consumption, in several ways. Sellers are not guaranteed financial success, but they are protected against market destabilizing stratagems, what used to be called unfair competition. This protection makes it less likely that retailers, and smaller companies in particular, will face such economic pressure that they will resort to selling practices that are outside the letter, and also the spirit, of the law. Profits were to be achievable for sellers who operated within the strict limits imposed by law.

There has been, in Washington as elsewhere, some rhetoric suggesting that alcoholic beverage regulation should be limited to policing the behavior of consumers and perhaps of retailers selling to consumers. Policing consumers and retailers must be part of the regulatory regimen, but a sensible comprehensive program should not be so limited. Laws to reduce pressures on retailers to oversell, to better monitor and control the price and quantity of goods arriving at retailers, to reduce pressures that would otherwise lead retailers to disobey the law to survive, do make sense. Such regulations together comprise a transparent and accountable distribution system.

A comprehensive regulatory program reduces the likelihood of point-of-sale violations and highlights that alcoholic beverages are products requiring control and self-control in their distribution, sale, and consumption. Not imposing all laws at one level, over any one group of participants, also reduces the risk that the regulated will become "demoralized", as it was termed when Prohibition was repealed. The concern, which was the result of direct observation during Prohibition, was that focusing too much regulation on one sector of the industry would create the impression that the regulated sector was somehow criminal. This would lead to a loss of respectability and would invite participants to view laws as obstacles to evade rather than as rules to be followed.

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Spreading the regulation throughout the distribution chain permitted each entity in each tier to face sufficient legal scrutiny to encourage voluntary compliance with the rules, subject to public review, but not such as to make any segment feel unfairly burdened. Comprehensive regulation is a manifestation of control, reflecting a determination that alcoholic beverages are a product whose use can create social costs and therefore demands public control.

The approach reflected in the original legislation, and still reflected in today's laws, is in effect "trust but verify," vesting significant self-control in drinkers and in sellers, but under legal supervision. A level playing field was sought not for its own sake, but to protect those sellers who acted within the law and to provide assurance that profits could be made by responsible parties.

This leads to my second point, which I will make only briefly. Washington, like other states, established a regulatory system that can be administered effectively. This is not achieved exclusively by direct supervision and, indeed, could not be. The cost and intrusiveness of such a program, with an inspector in effect supervising each point-of-sale transaction, is obviously insupportable. Rather, the system must depend to a significant degree on the willingness of members of the industry to submit to regulation and the self-interest that leads industry members complying with the law to report those who do not comply to the appropriate authorities.

One factor often cited for the ineffectiveness of Prohibition was that no economic interests had a stake in its success. The Repeal system, through licensed distributors and retailers, aimed to rectify this omission. Licensed distributors and retailers were expected to aid in law enforcement by identifying violators. Their economic interest was obvious; their knowledge of the industry was useful. Those who were willing to forego short-term gains and accept the constraints which limited them were rewarded and, in return, were to serve as a mechanism for enforcement of the state's rules. It should be noted that much law enforcement in the U.S. is complaint initiated. This reflects fiscal pressures and a recognition that neighbors and competitors have particular knowledge of what goes on around them and particular concern that what does go on be lawful.

Washington's present statutes work to promote stability and, therefore, control abusive and non-abusive consumption. They are enforceable without an uneconomic and unrealistic commitment of money and manpower. I submit, based on my knowledge of the history of alcoholic beverage regulation in the United States, that the laws are sound and should not be tampered with lightly.

Sincerely,

Stephen Diamond

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To: Three-Tier Review Task Force Members

From: Dr. Ken Casavant
Marketing Economist

Subject: Comments on “Candidates for Change” in Three-Tier System

Date: June 2, 2006

I am an agricultural economist in the School of Economic Sciences at Washington State University. I received my Ph D from Washington State University in 1971, after having received my Bachelor of Science and Master of Science from North Dakota State University in 1965 and 1967, respectively. I have been on the faculty of Washington State University for 36 years where I teach and conduct research in food economics and marketing. My areas of teaching are in management, marketing, pricing and policy. My principal area of research interest is the marketing of food, especially logistics and transportation, and other policy aspects of the marketing functions.

I have been asked by the Washington Beer and Wine Wholesalers Association to review the materials developed by the Task Force and offer my professional evaluation of the economic and social impacts of some of the “candidates for change.” During the past two years I have studied the industry, focusing on the three-tier system and its rules/regulations, and have collected, read and evaluated most of the relevant academic and industry literature in the area of alcohol abuse, regulatory standards and market efficiencies. I offer these comments for the consideration of the Three Tier Task Force in their deliberations.

The three tier system and general tied house laws

The net effects of the three-tier system and the other beer and wine regulations are somewhat higher prices, much more controlled access, and more effective tax collection; all have been identified as historical goals of the regulatory structure.

Understanding the functions of the three tier system requires an understanding of the history of the regulatory system in Washington.

As prohibition ended, the goals of restructuring were varied but included eliminating bootlegging (the sin of the Prohibition era), minimizing illegal alcohol sales with their accompanying loss of taxes, and discouraging moonshine activities. The overall societal charge was, “people wanted to drink, how should they do it and how should it be regulated?”

The general response was the three-tier distribution system where producers were distanced from retailers by the functions performed by the distributors. A balance was to be struck between prices so low that consumption was encouraged and prices so high that bootlegging was feasible, within a system where retailers were not driven by producers.

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The specific goals underlying the the Steele act were the continuance of temperance, fairness amongst the participants in the marketing system, orderly marketing and production of tax revenue reflecting the consumption of the product. Because of the social costs of alcohol, which had become all too evident during Prohibition and the years leading up to Prohibition, it was clear that, with respect to beer and wine, the lowest cost for the consumer is not the lowest cost for society. The distribution system was designed to create a balance between social costs and individual consumer costs, while preserving control and furthering the other goals of the State.”.

This history leads to two questions: First, are those original goals still relevant today? Second, how were the goals to be accomplished when the law was first enacted?

Control of alcohol abuse and attendant social costs has not changed, from the view point of this economist and citizen of Washington. The overall operational approach by the state of Washington was to impose some constraints on the unfettered competition that had brought on Prohibition in the first place. The current system is designed to use the three-tier distribution system to achieve the goals identified above. Within the system are the varying components or statutes addressing the posting and holding of prices, the illegality of quantity discounts or the granting of credit, the equal delivered prices and the minimum markup requirement. This is a belt and suspenders system that serves to backup and achieve the overall goal. Each can stand by itself to varying degrees in the function they perform but they each serve to make the goal more achievable.

The essential question again is just what was the state trying to do and does this system achieve those goals. Temperance, orderly marketing and fairness in the market place were desired after the experiences before and during Prohibition. The desire to stop the breweries from controlling and forcing the actions and output of the retailers, while making alcohol more expensive and less accessible/attractive was filled by the various statutes.

When the legislature chose to support the three-tier system they placed value on the existence and role of the distribution system, namely the distributors in the market. My knowledge of marketing, and my review of marketing studies, have reinforced the common knowledge of the benefits and value created by the Washington beer and wine distributors.

First, and perhaps most critical from the viewpoint of the framers of the legislation, is the separation of the large producers from the retailers in the marketing channel. The absence of this separation, and the control of producers over retailers, was the source of many of the undesired results leading to Prohibition. Using distributors as a buffer between the suppliers and the retailers serves to balance market power. This balance, and the consequent absence of ‘tied houses”, result in individual firm decisions that are more driven by an overriding desire for volume sales without consideration of the social costs of that consumption. Moreover, one of the results of this slightly constrained market is that

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transactions are, if not completely open, far more transparent and accountable due to the post and hold requirements and the bans on credit and quantity discounts.

Distributors provide numerous services, from rotating the product on the shelves, to chilling beer at all stages of the supply chain, to dating and coding beer and wine as to age and quality. All of these improve product quality for the consumer. Distributors take back and destroy old beer, absorbing the loss. Distributors carry at least as much of the risk of new or experimental products being rejected by consumers as do retailers, helping to encourage new product development and testing to occur in the market. Many more wine labels, and therefore the product of smaller wineries, are carried, inventoried and made available to the consumer by the distributors, because the size of the distributorship allows a greater inventory to be maintained and economies of scope to be achieved.

Important to the goals of the statutes, the distributors collect and return taxes efficiently. In sum, without the restraints built into the current regulatory system, we could end up with a system that is “efficient” when viewed purely from the point of view of individual businesses in the system but when viewed from the perspective of society in general neither maximizes the public good nor is “fair” in any meaningful way.

Level Playing Field Concept

The concept of a “level playing field” manifests itself in several of the restraints in the current system. As an economist, I would expect elimination of the restraints to result in fundamental changes in the marketing structure for beer and wine. Allowing quantity discounts and granting of credit, as well as eliminating the minimum markup, would have the effect of lowering some prices to some consumers, with attendant increases in quantity consumed and in opportunities for abuse. Further, the larger chain box firms would gain and the smaller mom and pop stores would be at a definite competitive advantage. To the extent the role of distributors is diminished, smaller retailers would be further disadvantaged. Significant inventory costs would be shifted to the retailer, the ability of new smaller wineries or breweries to get shelf space would be decreased, and other similar size-related impacts could be expected.

Without the uniform pricing requirement, service in outlying areas would be curtailed or price, selection and availability would be restricted. The current system essentially cross-subsidizes retailers in more remote areas and smaller retailers, much as electricity, phone service, mail service, highways, and other public utilities are cross-subsidized. One of the lessons learned from Prohibition is that making beer and wine too difficult to obtain will lead to illegal manufacture and sale, and to a disregard for the law. The concept of subsidizing smaller and more retailers to minimize that risk was built into the regulatory system from its inception.

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Allowing volume and credit discounts, or central warehousing, could essentially bring back the “tied houses”, with the result being significant pressure to increase the volumes of beer and wine sold by, among other things, reducing the price. This of course would lead to increases in abusive consumption, such as more availability of alcohol to our youth. None of these outcomes correspond with the express goals of these regulations.

Related to the level playing field are regulations implementing the law prohibiting distributors or suppliers giving “money or money’s worth” to retailers, including the ban on joint advertising. These are intended to preserve the separation of the tiers by outlawing efforts by one tier to subsidize the activities of another tier. Economically, eliminating these restraints would give rise to relationships that influence the retailer as to what is purchased from which distributor or producer.

Further, when retailer activities are subsidized the cost of incurred by retailers in selling beer and wine is reduced. This will inevitably result in increased promotion, particularly price promotion, which translates directly into greater consumption and more abusive consumption. It is my personal experience that, in a college environment such as Washington State University, such promotions are very effective in increasing purchases of beer and wine, including illegal purchases by minors, and in increasing excessive consumption.

In Summary

The material available from the interviews thus far seems to indicate the debate is not about whether these restraints exist but is rather about whether they are effective and at what cost. Private efficiency could be improved by removing some of these restraints, but as an economist I believe the larger concern that needs to be addressed is the impact on social costs that would be caused by the relaxation of these controls? Specific attention should be paid to the Liquor Control Board’s mandate, its effectiveness in enforcing that mandate and the net result on Washington citizens and businesses. My sense is that role is being performed more than adequately at this time; the Three Tier Task Force is being asked to consider what the mandate is, and is the balance between social costs and private firm efficiency appropriate at this time?

There is obviously some disagreement between members of the Task Force as to the balance to be struck between private operational efficiency and the public costs imposed by that efficiency. I cannot, as an economist, make a determination as to what level of public costs should be considered acceptable by Task Force members. Nonetheless, it is patently obvious that social costs are imposed on society as a result of alcohol abuse and that those costs are all too real.

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The public costs of alcohol abuse, while varied, include: the accidents and deaths attendant upon drinking and driving; the problems resulting from drinking by our youth and young adults; the health care costs incurred as a result of consumption, such as the costs of dealing with cirrhosis, and as a result of the addictive nature of alcohol; the costs of alcohol-related incidents such as accidents at work, suicide, child abuse (especially by women), spousal abuse, rapes, robberies, and violence on campuses. There are, of course, some health benefits that appear to flow from moderate consumption of alcohol but there is nothing in the literature or in my examination of the markets that suggests the current regulatory system unduly restricts moderate consumption.

It is also patently obvious to me as an economist that these social costs increase with consumption and that consumption will increase if prices to consumers go down. Finally, it is equally obvious that prices to consumers will go down, and abusive consumption will go up, if private efficiencies are the sole basis for determining the nature and scope of regulations governing beer and wine distribution.

It is the role of the Task Force to make policy recommendations as to the appropriate balance between social costs and private efficiencies. My role as an economist is simply to inform as to the type and magnitude of efficiencies and public costs/benefits that should be considered in making those recommendations. I appreciate the opportunity to offer some thoughts on the issues.